LESSONS LEARNED ON THE APPLICATION OF EPA'S AUDIT AND NEW OWNER POLICIES TO THE OIL AND GAS PRODUCTION SECTOR

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1. Initial Determinations of Potential Violations Can Be Challenging.

* The Audit Policy defines the "discovery" of a violation as "when any officer, director, employee or agent of the facility has an objectively reasonable basis for believing that a violation has, or may have, occurred." The "objectively reasonable basis" is considered to be what a prudent person, having the same information, would have believed. This inherently ambiguous standard is particularly difficult to ascertain in the oil and gas production sector.

* It can be very challenging to determine when a violation "may have" occurred when hundreds of facilities have been acquired and an entity may have imperfect information that needs to be reviewed and confirmed. For instance, a belief that facilities may have been improperly permitted based on production levels at the time of acquisition may lead personnel to suspect that violations have occurred, but a company will not be able to make a definitive determination until it calculates a site's emissions or potential to emit after taking condensate samples, developing emissions factors, and applying those calculations to production data. This process is even more complicated by the need to make source-by-source determinations after evaluating equipment and equipment-specific calculations, such as the potential-to-emit of storage vessels.

* EPA recommends in the Audit Policy that if a company has some doubt as to the existence of a violation, that the company proceed with disclosure and allow the regulatory authorities to make a definitive determination, but this could mean hundreds of disclosures that all must be addressed within 60 days.

* Suggested Fix: Establish a policy that deems "disclosure" to occur when the new owner completes its audit of the facilities at issue and submits a report to EPA summarizing the company's findings for a certain type of violations (e.g., permitting, vapor control systems, NSPS and NESHAP, etc.). "Disclosure" should be deemed to take place within the first 60 days of acquiring the assets, or after the new owner has completed its evaluation of that particular regulatory requirement.

2. There is Inadequate Guidance on Penalty Mitigation Under the New Owner Policy.

* In order to determine whether to voluntarily self-disclose a violation, a company needs to understand how penalty mitigation will be granted under the Audit Policy or New Owner Policy. This is challenging given the lack of guidance on this issue for new owners.

* Currently, the best method of assessing potential penalties is to look at consent decrees and their associated penalties, but consent decrees do not explain what percentage of the penalties are attributed to the gravity based component or the economic benefit component of the fine.

* According to the New Owner Policy, new owners are liable for the "economic benefit" that they receive from non-compliance post-acquisition, but it is unclear what is encapsulated in the economic benefit or gain that a company receives when it acquires facilities that require substantial retrofitting and improvements. For example, is the cost of a company's audit and the cost of all corrective action subtracted from EPA's calculation of the economic benefit? Is the company liable for post-acquisition economic benefit if it completes the audit activities within the timeframe agreed by the parties and undertakes corrective action within the schedule approved by the agency?

* Suggested Fix: Provide guidance on whether and to what extent companies will face penalty exposure for violations evaluated and reported post-acquisition. EPA should clarify, among other things, that companies will not be held responsible for economic

benefit post-acquisition as long as they identify violations within the timeframes agreed by EPA and complete corrective action within the schedule approved by EPA.

3. Uncertainty Exists as to the Terms of New Owner and Audit Agreements.

* EPA's guidance, "Corporate Auditing Agreements for Audit Policy Disclosures" states that an exchange of letters is sufficient for audit of less than six months, but in practical terms an exchange of letters is appropriate for longer and more complex audits. This should be clarified to save companies from spending time developing a proposed consent decree like audit agreement or from being detracted from having to engage in lengthy negotiations.

* Companies are wary of entering into agreement where the form and terms of the agreement are unknown. EPA has had few new owner agreements, and what agreements exist are difficult to access and review. Even where a company submits the necessary information needed to apply for a new owner agreement, it doesn't know what terms might apply until it receives a letter from EPA. If the company disagrees with the exchange of terms, it has no choice but to rescind its request or reject the terms. This is not an agreement, it is simply an exchange of letters, and an inefficient means of trying to reach a true agreement.

* "Corporate Auditing Agreements for Audit Policy Disclosures" is available at: https://www.epa.gov/sites/production/files/documents/corporateauditagreecorrection050701.pdf

* Suggested fix: Develop and publish a model audit agreement and new owner agreement.

4. The Current Policy Provides Inadequate Timing for Developing and Executing an Audit Agreement, Leaving New Owners at a Disadvantage in Negotiating the Agreement.

* EPA Policy provides new owners with nine months from the date of transaction in which to make disclosures or execute an audit agreement (currently preferred through an exchange of letters) with EPA. Although that may be a sufficient amount of time for the acquisition of a single facility or a handful of facilities, it is inadequate for large acquisitions of facilities.

* Even if an audit agreement takes the form of an exchange of letters, it can be a time consuming process. In the case of oil and gas production sites, discovering violations involves dozens of regulations that require the collection of data and the performance of calculations and modeling-all of which takes substantial time.

* In one case , the closing of the acquisition occurred in September 2016 and the audit agreement was not finalized until August 2017. Since an audit agreement is supposed to be concluded within the nine-month window, the company had to seek extensions. EPA used the threat of refusing additional extensions to unfairly extract concessions from the company, including legitimate concerns the company raised about schedule and EPA's insistence on questionnaire items that had no application to the acquired sites.

* Suggested Fix: EPA should provide that only an initial disclosure of potential violations and a notice of intent to enter into an audit agreement must be performed within nine months.

Alternatively, the new owner window should be increased to one year so as to encourage companies to self-disclose without fear of not being able to negotiate an audit agreement within the nine month window. And as mentioned earlier, EPA should expedite negotiations by developing a model agreement, rather than an exchange of letters.

5. EPA's Default Corrective Action Window of Sixty Days is Generally Insufficient to Conduct Corrective Action After a Large, Multi-Facility Acquisition.

* In many, if not most cases, corrective action requires more than 60 days. Consequently, the requirement that a company conduct all corrective action within 60 days, unless permission is granted by EPA to extend that deadline, leaves a company at risk on self-disclosing violations and not receive penalty mitigation.

i. An example of 60 days simply not being possible, is where equipment for a closed vent system must be ordered and installed and vapor control equipment, such as an enclosed burner unit, must also be ordered and installed. The difficulty in completing this is even more challenging when there are dozens of sites that require installation of the equipment. In cases where only a potential violation was disclosed, modeling and calculations would need to precede the ordering and installation of equipment as

well.

ii. Complying with the 60 day window is also not possible in cases where an air permit can only be obtained after corrective action at a well site has been completed. The state may require that a permit be obtained based on a sites completed well design, because the installation of emissions controls will reduce the sites potential to emit and therefore qualify the site for a different type of permit or exemption. As such, a permit application cannot even be submitted until the emissions controls have been installed. This will generally require more than 60 days.

* EPA's current policies provide that EPA may grant extensions of time, but only once the 60-day default corrective action period has already commenced. Consequently, even when the company is certain it will need additional time, EPA is hesitant to provide extensions of the 60-day period where all the parties recognize that the work cannot possibly be completed within a 60-day window. EPA's response that companies should trust the agency to be reasonable with extensions is little comfort to new owners facing significant liability for violations that cannot be quickly corrected.

* EPA has made exceptions to its position on extensions, however. The AT&T audit agreement in EPA's "Corporate Auditing Agreements for Audit Policy Disclosures", for example, provided that only notice must be given to EPA for an extension but that permission is not required. This model audit agreement therefore is misleading, based on EPA's current practices.

* Suggested Fixes: Either allow companies to simply provide notice to EPA of additional needed time for corrective action or change EPA's policy to allow companies to negotiate corrective action schedules up front, rather than once the 60-day period has begun.

6. Clarify Exceptions for Imminent and Substantial Endangerments.

* EPA's New Owner Policy appropriately reserves EPA's rights to accelerate a negotiated corrective action schedule to address any imminent and substantial endangerment that may arise at a facility.

* What constitutes an "imminent and substantial endangerment" is fairly broadly defined in caselaw, which raises questions regarding whether EPA might unilaterally accelerate the agreed-upon corrective action schedule based on a determination that emissions controls are inadequate after an audit agreement has been executed.

* Suggested Fix: Clarify that the negotiated corrective action schedule will remain intact, except that EPA retains all of its authorities to issue a separate imminent and substantial endangerment order under Section 303 of the Act.

7. Clarify What Constitutes Corrective Action.

* EPA needs to clarify what measures constitute "corrective action", particularly in the context of permitting corrective action.

* For instance, does the submission of permit applications constitute corrective action or does a company need to obtain the new permit before certifying compliance?

* Also, can the company take into consideration the emission controls it will be installing (and hence become a minor source) when submitting a permit application, or does the corrective action have to include a permit application and then a subsequent permit modification once controls are installed?

* Suggested fix: Develop guidance on what constitutes corrective action, at least for post-acquisition permitting.

8. The Application of the Audit Policy's Systematic Discovery Criterion to New Owners is Unclear.

* Under the Audit Policy, any violations eligible for favorable self-disclosure treatment must have been discovered through some type of program of systematic investigation, such as an environmental audit or a compliance management system. An environmental audit is considered "a systematic, documented, periodic and objective review by regulated entities of facility operations and practices related to meeting environmental requirements."

* The New Owner Policy changes this criteria by providing that the "periodic" requirement in the case of pre-acquisition due diligence, but keeps it for all other

cases. Therefore, under the policy, a company could miss non-compliance during pre-acquisition due diligence, then audit the facilities once they have ownership and full control over them and not be eligible for full penalty mitigation. They would be eligible for only 75% penalty mitigation since discovery would not be considered systematic. This does not make sense since a party will not have ownership of the facilities and therefore cannot properly audit them until closing.

* Suggested Fix: A company should be allowed to perform a one-time audit following acquisition of new facilities to verify compliance and the periodic requirement should be dropped altogether in the new owner context. Otherwise, it should be clarified whether a company must have a commitment to conduct periodic audits on an ongoing basis in order to qualify for the systematic discovery criteria.

9. Prior Data and Regulatory Applicability Determinations From the Prior Owner May be Unreliable.

* The VOC and methane capture regulations (40 C.F.R. Part 60, Subparts OOOO and OOOOa) require a determination as to whether storage vessels are subject to the regulations to be made in the first 30 days following start-up, but a new owner may need to determine whether newly-acquired storage vessels are subject to these regulations outside that window if the prior owner did not make a determination or the determination appears faulty. Further complicating the matter, the new owner may not have accurate data from the first 30 days following startup, which could have been years ago. The New Owner Policy should clarify whether a company may make an assessment based on current, post-acquisition data.

* An associated point is whether a new owner is required to rely on applicability determinations made by the prior owner or data collected by the prior owner. It would not be protective of the environment to require a new owner to abide by an applicability determination made by a prior owner that the new owner knows is wrong, but this may also require the new owner to conduct new applicability determinations.

* Suggested Fix: Clarify, in guidance, that new owners may make applicability determinations based on post-acquisition data they gather, and provide companies with sufficient time (such as nine to twelve months after the audit agreement) in which to make such determinations.

10. Clarify Federalism Approach for Agreements with States.

* States vary significantly in their respective approaches to audit disclosures. Some have audit programs by statute, some by regulation, and some by guidance. Others, such as Louisiana, have no such program and maintain that it is simply a consideration to be taken into account by the state in determining the appropriate enforcement response.

* Under the Clean Air Act, the state agency is normally responsible for implementing the statute and is the permitting authority, which means that a self-disclosing company must please both the state agency and EPA (even though the state may not have a self-disclosure policy).

* In some instances, EPA has over-filed, finding the state program or its oversight of an audit agreement to be inadequate. This creates unnecessary uncertainty for the new owner, and provides a disincentive to entering into any such agreement.

* Suggested Fix: Clarification is needed to explain whether and to what extent a company has to enter into audit agreements with both federal and state regulators, and the extent to which one agency would recognize an agreement with the other.

11. De-couple the Audit Policy's New Owner Questionnaire from New Owner Situations.

* The New Owner Questionnaire was not designed for new owner audit agreements, and is inappropriate for large, multi-facility audits. In circumstances involving new owners and existing owners a company has to collect and submit unnecessary information. Even as applied to companies that are new owners, the questionnaire has been conveyed as non-negotiable, despite the fact that it was never subject to notice and comment, and never publicly made part of the audit policy or new owner policy. Although EPA may rightfully ask for new owners to track certain information, the current questionnaire is unnecessarily time consuming and wasteful.

* For instance, where a company is auditing hundreds of oil and gas sites, using dozens of staff, both in-house and consultants, to collect information, conduct inspections, perform calculations, make regulatory applicability determinations, and other audit

activities, it is unclear how the entity identifies the name, title, employer, and education / training of each individual who discovered each violation. Requiring the entity to report the persons responsible for the audit serves a clear purpose, but EPA has been unwilling to engage in discussions to tailor it to the audit being performed.

* Suggested Fix: Revisit the Audit Agreement Questionnaire and submit a more streamlined version for public notice and comment. Separately, draft a questionnaire specific to new owners.

12. Distinguish Audit Investigations from Other Clean Air Act Monitoring and Reporting Obligations.

* EPA needs to clarify whether its audit obligations should include monitoring and reporting obligations that would exist independent of any audit agreement.

* The regulations at 40 C.F.R. Part 60, Subpart OOOOa, for example require that a company conduct semi-annual leak detection and repair (LDAR) surveys. Any leaks discovered must be repaired within 30 days. Further, the company must report any deviations from the requirements on their annual report. Since oil and gas companies are already required to perform semi-annual inspections at each well site and report any discovered deviations, it is unclear why they would self-disclose such leaks as violations. Even if such inspections and reports are included, it's unclear whether the 30-day window in which to rectify any leaks would be able to utilize the 60-day window for corrective action under its audit agreement instead.

* Suggested Fix: EPA should clarify whether violations discovered based on other Clean Air Act monitoring and reporting programs (beyond Title V) should nonetheless qualify for audit policy protection or whether these violations cannot be considered voluntarily discovered.

1 This paper reflects solely the views and opinions of its authors based on their experience applying EPA's Audit and New Owner Policies for companies engaging in oil and gas exploration and production, and is not intended to reflect the views of any particular company the authors may have represented.

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